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(Article begins on next page)

Monitoring Macroeconomic Imbalances:

Is EU surveillance more effective than IMF surveillance?

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Introduction

This paper examines the Macroeconomic Imbalance Procedure (MIP) that was introduced in December 2011 as an integral part of the EU economic surveillance framework. In doing so, this study's primary purpose is to begin assessing the potential effectiveness of the MIP, specifically its ability to identify macroeconomic imbalances and induce remedial policy action. Because the MIP is a relatively new procedure and the empirical evidence upon which to judge its results is still limited, this paper assesses its potential effectiveness by comparing it with a similar initiative, the International Monetary Fund's (IMF or Fund) macroeconomic surveillance. At first glance, the comparison reveals that the effectiveness of the MIP is potentially greater than that of the IMF surveillance because the MIP has remedied some well-known limitations in the Fund's monitoring activity, including the lack of clear and practical advice, the limited knowledge of domestic polities and the reluctance to activate sanctions to induce corrective action.

Upon closer inspection, however, the comparison reveals a far more mixed picture of the MIP's effectiveness. In particular, if we move from a purely formal analysis of the MIP's institutional design and operating procedures to an assessment that takes into consideration the political-economic factors that are likely to affect the MIP's actual implementation, the effectiveness of the MIP appears more limited. Indeed, the MIP's effectiveness may be compromised by its limited used of reversed qualified majority voting (RQMV), which is confined to the corrective stage of the surveillance process. Furthermore, the absence of mechanisms to prevent arbitrariness in the application of sanctions and the asymmetry that characterises the MIP adjustment process open the door to political interference and public backlash that risk diminishing the MIP's effectiveness. Finally, although important attempts have been made to incorporate the MIP into the broad EU economic surveillance framework, financial and economic analyses are yet to be fully integrated, and the MIP's predominant focus on single countries' macroeconomic developments may lead the procedure to miss important systemic aspects – that is, the build-up of imbalances that concern a group of countries together.

Interestingly, the MIP's shortcomings relate to a number of issues in which the IMF surveillance experience could have provided policy guidance to EU policy-makers. In spite of the available policy lessons, however, there is no evidence that EU policy makers consciously turned to the Fund's experience for guidance during the design of the MIP.[1] To account for this failure to incorporate previous lessons learned, three factors are tentatively suggested in the concluding section. These factors include the presence of competing domestic experiences, the institutional fragmentation of the EU and the political cleavage between creditor and debtor countries.

Before proceeding, three clarifications are needed regarding the focus and concepts used in this analysis. First, although the MIP is part of the broader reform agenda of EU economic governance, the paper concentrates solely on the characteristics of the surveillance framework that has been developed to detect and prevent macroeconomic imbalances. Thus, the other important items in the EU economic governance agenda, including the reinforcement of the Stability and Growth Pact (SGP) and the fiscal compact, will be left outside the analysis. Furthermore, this paper does not attempt to explain the origins of the imbalances, although a lively debate exists on this important issue.

Second, the paper embraces a definition of effectiveness that is in line with the definition common in the literature on international regimes (c.f. Young, 1999).[2] Specifically, effectiveness refers to whether the regime (or in this case, the specific surveillance initiative) 'solves the problem that motivated its establishment' (Underdal, 2002, p. 11). In other words, effectiveness refers to the ability to achieve specific outcomes or solve specific problems. In the cases under investigation, effectiveness thus refers to the ability to identify macroeconomic imbalances in a timely manner (i.e., prevention) and to induce corrective action at the domestic level when imbalances are identified (i.e., correction).

Finally, as this paper relies on a focused comparison between MIP and IMF macroeconomic surveillance,[3] it is necessary to clarify from the outset why such a comparison is warranted. To start with,

[1] As one official put it, 'the lack of a debate on IMF surveillance was conspicuous by its absence'. Interview with a European Central Bank official. Frankfurt, 14 March 2013.

[2] For a different conceptualisation of effectiveness, see, for instance, Gutner and Thompson (2010).

[3] The scope of IMF surveillance was originally conceived as surveillance over exchange rate choices. Over time, however, it has become increasingly recognised that the external position of a country is affected by a broader set of policies, including structural and financial sector policies.

similarly to the MIP, the Fund's surveillance focuses on both internal and external disequilibria. In particular, according to its Articles of Agreement (Article IV, Section 3), 'the Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations'. The latter refers to the obligation of promoting economic and financial policies that do not produce erratic disruptions or prevent balance of payment adjustments in the global economy and that instead foster orderly economic growth (see, also, Mussa, 1997). IMF surveillance also constitutes an effective reference point against which to assess the MIP because, like the MIP surveillance, it is mandatory for member countries and its institutional design comprises a preventative and a corrective arm.

The paper is organised as follows. In Section 1, I review the main features of the MIP. Section 2 introduces the main findings on the effectiveness of the Fund's macroeconomic surveillance. Section 3 then assesses the MIP against the findings analysed in the previous section. Specifically, the paper assesses the extent to which the MIP has remedied the problems that are widely recognised to have impaired the effectiveness of IMF surveillance. Section 4 discusses the limitations of the MIP. Finally, Section 5 concludes by reflecting on the implications of the findings and on the ability of the EU to learn from outside experiences.

1. The institutional design and operational procedures of the MIP

The MIP entered into force on 13 December 2011 within the framework of the so-called 'six pack' set of legislation. Specifically, two regulations lay the foundations for the prevention and correction of imbalances: Regulation (EU) No 1176/2011, which sets out the details of the new surveillance procedure and applies to all EU Member States, and Regulation (EU) No 1174/2011, which is only applicable to the Eurozone members and provides for enforcement mechanisms.

The purpose of the MIP is to prevent and correct macroeconomic imbalances that indicate 'any trend giving rise to macroeconomic developments which are adversely affecting, or have the potential adversely to affect, the proper functioning of the economy of a Member State or of the economic and monetary union, or of the Union as a whole'. Imbalances are considered 'excessive' when they jeopardise or risk jeopardising the proper functioning of the economic and monetary union (Regulation 1176/2001, Article 2). In spite of this apparently clear definition, identifying when an imbalance becomes excessive is a controversial activity.

To start with, imbalances themselves do not represent an immediate threat: external deficits are usually financed by borrowing from the rest of the world. The problem lies in anticipating the moment at which private lenders will cut lending and ask for repayment. Furthermore, there are many sources of macroeconomic imbalances, and conflicting recommended diagnoses. For instance, there are at least two competing explanations for the external imbalances of euro area countries: imbalances are explained as either the outcome of undisciplined fiscal policies or the consequence of divergences in saving patterns (Wyplosz, 2010). Under the first reading, expansionary fiscal policies in the deficit countries supported domestic demand that then led to higher inflation. Relative prices between different Eurozone countries became sizable, with consumer prices and unit labour costs rising very significantly in the Eurozone periphery relative to the core, and particularly vis-à-vis Germany (Chen et al., 2012). Under the second explanation, however, declining savings rates led to excessive imbalances because they reflected rapid credit growth and poor market discipline (De Grauwe and Ji, 2012; Gros, 2012). Easy financing would have allowed deficit countries to sustain the appreciation of real effective exchange rates and delayed the need for adjustment (Chen et al., 2012, 3)

Whatever their origins, the crisis in the Eurozone has emphasised the impact of imbalances on the stability of the monetary union. As two top officials of the Directorate-General for Economic and Financial Affairs explain, the European debt crisis cannot be solely traced back to fiscal profligacy but is part of a much wider set of macroeconomic and financial developments that must now be monitored (Buti and

Carnot, 2012, p. 905). The MIP can thus be conceived of as a complement to the operation of the Stability and Growth Pact (SGP).

As for the modalities of the new EU surveillance, the procedure starts with regular checks on Member States' economic policies. Specifically, each year, the Commission publishes an Alert Mechanism Report (AMR) with the objective of providing an overview of the developments of key macroeconomic indicators in the Member States, including indicators of external competitiveness and internal imbalances. In addition to the application of the indicator-based scoreboard, the assessment of the Commission is based on a qualitative analysis. This approach gives the EU Commission both flexibility and a high degree of discretion in interpreting the data.

It is also important to note that the findings of the AMR do not automatically trigger action; rather, they serve as a filter with which to identify countries and issues for which more in-depth analysis is required.[4] It is only following feedback from Member States that meet in the Council and the Euro Group that the Commission decides on the countries for which it will prepare in-depth reviews. These reviews aim to assess the origin, nature and severity of possible macroeconomic imbalances. Their drafting may involve missions to the Member State concerned. If the Member State is part of the Eurozone, the Commission may invite representatives of the European Central Bank to participate in surveillance missions.

The in-depth reviews can lead to three different outcomes. First, if the European Commission does not detect any macroeconomic imbalances, it will not propose any further steps. Second, if macroeconomic imbalances are detected, the Commission advises the Council to issue recommendations for preventive action to the affected Member State based on Article 121(2) of the Treaty on the Functioning of the European Union (TFEU). Under these circumstances, the European Council will issue recommendations for the correction of the macroeconomic imbalances to the Member State as part of the country-specific recommendations issued in June. Third, if the European Commission detects excessive imbalances that

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[4] At the time of writing, in-depth reviews have been published in May 2012 and April 2013 for 12 and 13 countries, respectively.

could jeopardise the functioning of the monetary union, it will advise the Council to issue recommendations for corrective action to the affected Member State based on Article 121(4) TFEU. In contrast to the second outcome, in this case, the ensuing recommendations will also activate the corrective arm of the MIP. In particular, the Commission will advise the Council to open an excessive imbalance procedure (EIP). One of the major innovations of the procedure is the use of RQMV. Under RQMV, a Council decision on a Commission recommendation regarding the activation of sanctions against Eurozone Member States is deemed to be adopted by the Council unless it decides, by qualified majority, to reject the recommendation within ten days.

The launch of the EIP implies that the Member State concerned will be placed under stricter economic policy surveillance. The Member State concerned will also be obliged to submit a corrective action plan (CAP). The CAP sets up a roadmap to implement corrective policy actions, detail the corrective actions that will be adopted and specify the implementation timetable. Under the EIP, implementation shall be assured by the Member State regularly reporting to the Council and the Commission on the progress made towards the implementation of the Council recommendations. The Commission will also assess the state's progress on the basis of these reports and possible country surveillance missions.

Under the EIP, financial sanctions are foreseen only for Eurozone Members. In particular, if the Member States concerned fail to comply with the recommended corrective action, an interest-bearing deposit equal to 0.1% of the country's GDP will be imposed. This penalty is to be deposited with the European Commission. A sanction can also be imposed for repeatedly failing to deliver "appropriate action" under the EIP. Specifically, two consecutive negative evaluations with regard to the corrective action plan or the implementation of corrective measures will entail an annual fine equal to 0.1% of the country's GDP. The EIP will be terminated once the Council, based on a recommendation from the European Commission, determines that the imbalances have been effectively eliminated.

2. What makes international economic surveillance effective? The IMF experience

Although the prevention (and correction) of macroeconomic imbalances is a relatively new task for the EU to perform, this activity stands at the core of the IMF's functioning since its creation at the end of the Second World War. Indeed, the Articles of Agreement mandate the IMF to exercise 'firm surveillance' over the economic policies of its member countries.[5] To fulfil its mandate, the Fund regularly monitors the domestic policies of its members to identify the potential sources of aggregate imbalances that could cause the deterioration of the country's balance of payments.

The Fund's record in fulfilling this mandate, however, is rather mixed. Although its analyses and advice are certainly an example of high-quality research and good intentions, the Fund has often missed the signs of impending crises. When the signs have been correctly detected, the Fund has failed to induce remedial political action from domestic authorities. The events associated with the latest financial crisis provide a good illustration of these arguments. In this case, as the Independent Evaluation Office (IEO) (IEO, 2011, p. 4) has authoritatively demonstrated, 'the IMF did not anticipate the crisis, its timing, or its magnitude'.

The failures of IMF surveillance have attracted attention both within and outside the Fund. Without claiming to be exhaustive, the main problems that have been identified can be separated according to whether they pertain to the content of the surveillance reports or to the procedures through which surveillance is conducted. Furthermore, the Fund's surveillance has been found wanting in both its preventative and corrective arms (Table 1).

[5] The term 'firm surveillance' was introduced in 1979 with the adoption of the second amendment to the Fund's Articles.

Table 1. Causes of the ineffectiveness of IMF surveillance

Starting from the upper-left quadrant of Table 1, three main problems have been identified to account for the Fund's limited effectiveness in detecting macroeconomic imbalances. First, IMF surveillance reports seem to have suffered from poor timeliness and a lack of specific advice. Regarding timeliness specifically, the time lag between the surveillance mission, the issuance of the staff report and the ensuing Executive Board discussion has usually been too long, with the result that recommendations are made public when they are no longer relevant to countries' economic problems (IMF, 2008). Furthermore, the Fund's surveillance advice has often been found wanting in terms of its limited specificity and practicality. For instance, interviews of country authorities have revealed that member countries perceive a lack of relevance and genuine value in some of the Fund's recommendations (IEO, 2013, p. 8).

Second, the IMF has been blamed for the fragmentation of its message. IMF analyses of domestic economies and global developments have been scattered and dispersed across the several surveillance reports that the IMF regularly produces (IMF, 2011a; Pickford, 2011). The fragmentation of the Fund's analysis also contributes to an inability to grasp both policy spill-overs across countries and economic and financial interconnections (IMF, 2011a; IEO, 2006). In short, the Fund has performed poorly in systemic surveillance.

Finally, IMF surveillance has long paid insufficient attention to financial sector issues and has thus failed to recognise the financial sources of macroeconomic instability (i.e., the so-called macro-financial linkages) (IMF, 1995, 1999). Although there have been important improvements in the Fund's financial analyses over time (Moschella, 2011), in the run-up to the 2007 crisis, staff continued to focus on factors such as global imbalances and disorderly dollar decline as the key risks to global stability, largely failing to take action to address the risks building up in the financial sector (IEO, 2011).

IMF surveillance has also been found to be of limited effectiveness in inducing corrective action, as evidenced in the upper-right box in Table 1. Specifically, many features of the Fund's reports have repeatedly weakened the influence of surveillance recommendations. To start with, IMF reports are often perceived as providing uneven, asymmetric treatment to different groups of countries. The general perception is that whereas advanced economies usually receive quite gentle advice, emerging market and developing countries receive much tougher analyses and stringent recommendations (IEO, 2013).[6] In short, countries are not always treated equally (Lombardi and Woods, 2008, p. 732), with negative consequences for the effectiveness of the IMF's policy advice. As surveys of country authorities reveal, the perception of even-handed treatment is a pre-requisite for seeking the Fund's advice and considering following it (IEO, 2013).

Another factor that weakens the corrective potential of IMF surveillance is the insufficient knowledge of domestic polity, politics and policy. IMF staff members are often unaware of the political challenges that domestic authorities are likely to confront in implementing the Fund's recommendations. For instance, interviews with country authorities reveal that a substantial number of country authorities believed that the IMF lacked sufficient knowledge of country specifics for its advice to be useful, especially in large emerging-market countries (IEO, 2013, p. 22).

Moving to the lower-level quadrants in Table 1, several procedural aspects are also recognised to have reduced the effectiveness of IMF advice. With regard to the preventative stage of surveillance, it has been noted that the Fund's analyses have often failed due to the organisation's reluctance to 'speak truth to power'. In other words, the candidness of surveillance reports has often been compromised by political (as opposed to technical) considerations (Cottarelli, 2005; Fratzscher and Reynaud, 2007; Odling-Smee, 2004). For instance, it is now widely documented that IMF staff members were 'overly influenced by (and sometimes in the awe of) the [advanced countries] authorities' reputation and expertise' and therefore felt uncomfortable challenging their views on financial regulatory and supervisory issues (IEO, 2011). A

[6] It is interesting to note that recent assistance programs for EU countries are seen by several national authorities outside Europe as a further instance of the uneven treatment that the Fund reserves for its members (IEO, 2013, p. 29).

corollary of the distortive influence that power considerations play in the conduct of the Fund's surveillance is that the Fund has no material influence over the economic policies of major developed countries that are not subject to Fund conditionality (IMF, 2011a, p. 20).

The Fund's ability to induce remedial political action is also weakened by a sort of 'top-down' approach to surveillance that limits the involvement of country authorities in the assessment of the domestic economy. This approach has been particularly detrimental to the influence of the Fund's recommendations because it has instilled in domestic authorities the feeling that they lack ownership over the content of reports. In other words, surveillance consultations have been perceived as a 'one-way process' in which IMF staff teams set the agenda and only require national authorities to 'tick boxes' (Momani, 2006) without being accountable for the political consequences associated with the implementation of the Fund's recommendations (Stiglitz, 2003, 118-120).

The effectiveness of the corrective arm of IMF surveillance is also negatively affected by the fact that it is unable to enforce members' compliance with its recommendations. As the Fund itself clarifies, 'the Fund's approach to surveillance has mainly relied on dialogue and persuasion, within a framework that includes specific obligations and guidance on the conduct of policies' (IMF, 2011b, 12). IMF surveillance thus represents a soft form of coordination in that it does not rely on either legal obligation or the threat of specific sanctions (Hodson, 2004); however, this does not mean that the Fund has no weapons with which to force members to comply with its recommendations. A member in breach of its obligations may be denied the benefits of membership and thus be ineligible to use the Fund's resources or exercise its voting rights and can even be expelled. Interestingly, however, no such sanction has ever been applied to members with respect to their surveillance obligations, and even when the Fund has considered the option of flagging non-compliance with its advice, its activities have been met with stiff resistance from member countries. The reluctance to use the label 'currency manipulator' against China after the adoption of the 2007 Decision is an apt case in point (Blustein, 2012).

In short, the history of Fund surveillance reveals important policy lessons about the factors that may result in ineffective international economic surveillance. In the following section, the paper assesses how the MIP performs as compared to these findings.

3. Assessing the MIP effectiveness: The strengths of the new procedure

Some notes of caution are first required. Specifically, it is important to stress that the assessment of the effectiveness of the MIP is in no way definitive, as no solid history of EU macroeconomic surveillance is available at this stage. At the time of writing, only two AMRs have been released (in February and November 2012), on the basis of which two sets of in-depth reviews have been undertaken to determine whether macroeconomic imbalances exist or are at risk of emerging (in May 2012 and April 2013, respectively). Furthermore, the new surveillance procedures have yet to become well-established practices, which could give rise to a gap between the proposed institutional design and its actual operation.

In spite of these observations, the rules enshrined in the MIP and the first surveillance assessments since 2011 provide empirical evidence for an initial systematic comparison between the new EU surveillance and Fund surveillance. The findings of the comparison are summarised in Table 2. The aspects in which the MIP appears to be potentially more effective than IMF surveillance are in italics.

Table 2. The effectiveness of the MIP as compared to the Fund's macroeconomic surveillance

Beginning with the strengths of the MIP, one of the first aspects worth noting is that the MIP is clearly inscribed into the framework of the European Semester. As a result, macroeconomic surveillance takes place in a timely and predictable fashion, with well-established monitoring steps distributed throughout each year. Strict deadlines throughout the surveillance process also aim at avoiding lengthy procedures. Furthermore, no significant time lags are expected to develop between the drafting of the reports and their technical and political discussion.

The reliance on a scoreboard to assess domestic economic policies is a further element that distinguishes the MIP from the IMF surveillance. In particular, the EU Commission is bound to develop its surveillance analyses based on a set of agreed quantitative indicators (complemented by qualitative analysis), which orient the Commission towards specific, pragmatic advice. The Commission's recommendations are thus expected to help member countries meet specific targets within previously agreed-upon thresholds. The same level of specificity is also found in the content of the corrective action programs.

The MIP also performs better than the IMF surveillance in at least one another important respect: the involvement of national authorities and the knowledge of domestic politics. Indeed, although the EU-domestic relationship may be undermined by the asymmetry that informs the procedure, as discussed below, the continuous interaction between the domestic and the EU levels is a bulwark against the perception of a 'one-way-process' that characterises the workings of the Fund. The design of the EU macroeconomic surveillance also increases its potential effectiveness as compared to the Fund's surveillance because it includes a number of features that strengthen the corrective arm. As distinct from the Fund surveillance, the consequences of non-compliance with the Commission and Council recommendations are clearly specified in advance. Furthermore, where the Fund is reluctant to use sanctions to induce compliance, based on the understanding that traction 'has to be earned' rather than imposed (IMF, 2011a, p. 20), the MIP makes sanctions a key instrument with which to achieve the correction of macroeconomic imbalances. As illustrated above, the corrective aspect of the MIP includes a list of sanctions that will be imposed if a country does not act on the proposed recommendations. In particular, under the EIP, financial sanctions (up to 0.1% of GDP) are proposed if the Member States concerned fail to comply with the recommended corrective action. A sanction can also be imposed for twice failing to submit a sufficient corrective action plan.

The MIP also introduces mechanisms to facilitate the activation of the prescribed sanctions. The introduction of RQMV is the key institutional innovation here because it enhances the likelihood that the surveillance process will proceed as planned rather than being blocked by political considerations. Specifically, the prescription that the Commission recommendations will be accepted unless rejected by a qualified majority in the Council increases the almost-automaticity of the process. The final warning, which is required for sanctions to be activated, will be adopted more easily if no majority is required for its adoption. In other words, a qualified majority is not required to activate sanctions, only to block them.

This procedure stands in stark contrast to most international economic surveillance, including that of the IMF. Indeed, it is largely acknowledged that one of the key problems in international economic surveillance lies in the political, consensual procedure that hinders the activation of the corrective mechanisms. In particular, it is difficult to see how commitments can be effectively enforced if a consensual decision has to be reached among all members, including the one that is deemed to have breached the rules.[7] This is exactly the criticism that has been raised of the SGP. Indeed, one of the key problems that made the excessive deficit procedure ineffective was that governments that breached the rules acted simultaneously as the accused, judge and jury (Buiter, 2006, p. 689).

Another major strength of the MIP as compared to IMF surveillance lies in its integration with the broad EU economic surveillance framework. For instance, if, on the basis of its in-depth reviews, the Commission considers that macroeconomic imbalances exist, it may issue policy recommendations for the Member States concerned. These recommendations will be part of the integrated package of recommendations under the European Semester aimed at assessing fiscal and structural policies in addition to macroeconomic imbalances. The MIP is also integrated with the enhanced surveillance framework introduced with the 'two-pack' legislation, which entered into force in May 2013 in all Eurozone Member States. In particular, to avoid the duplication of monitoring and reporting obligations, the implementation

[7] For example, in the Financial Stability Board, a country is unlikely to have its membership revoked for non-compliance unless it supports the decision in the Plenary against itself (Helleiner, 2010; Moschella, 2012).

of the MIP and its corrective arm will be suspended when the member country concerned is under a macroeconomic adjustment programme.

A first-cut assessment of the MIP against the benchmark provided by the IMF leads to the conclusion that the effectiveness of the new EU surveillance is potentially greater than the Fund's surveillance. Specifically, the MIP is based on a more systemic and timely dialogue between EU institutions and domestic authorities, and its analyses are based on clearly specified indicators that may help increase the precision and practicality of the EU recommendations. These recommendations, in turn, are largely integrated into the EU broad economic surveillance framework. The MIP is also better placed than IMF surveillance in its corrective arm because it relies on the use of sanctions, whose activation has been made easier by the introduction of the RQMV.

4. Assessing the MIP's effectiveness: The weaknesses of the new procedure

Although the MIP presents some more effective mechanisms than IMF surveillance, a closer examination of the new EU surveillance leads to a more nuanced assessment of its effectiveness. Specifically, some problematic aspects characterise its institutional design and operating procedures. These aspects are particularly evident when the economic and political realities in which the EU operates are taken into consideration.

To start with, and in spite of the important efforts at facilitating the activation of sanctions through the use of RQMV, the new voting majority is confined to the corrective stage of the surveillance process. In contrast, the RQMV does not apply for the Council discussion of the AMR, on the basis of which the list of Member States for which in-depth reviews are warranted is identified. Furthermore, the question can still be raised as to whether sanctions will be activated at all, especially towards the core Eurozone countries. The experience with the SGP does not bode well in this respect. Although the SGP already provided for the use of sanctions, the Council decision in November 2003 to suspend the excessive deficit procedure (EDP), under pressure from Germany and France, left the impression that political considerations constrain the activation of sanctions even when the latter are clearly specified. In light of this experience and in spite of the letter of the MIP, there is no certainty that the new surveillance design will be more able than the IMF to overcome the limitations of the enforcement mechanisms in its operational practice. This challenge is especially formidable when large states exercise their discretionary power (c.f. Schure and Verdun, 2008), similarly to what occurs with the IMF, whose surveillance meets the greatest difficulties when directed at the major industrial countries (Boughton, 2001, 135). In short, it is not obvious that the existing sanctions would actually become credible even if they were made tougher and their use simpler to activate (Wyplosz, 2010).

There are already rumours that this scenario materialised in the first alert mechanism reports prepared by the Commission in February 2012. For instance, it was leaked to the press that 'Italy was spared harsh criticisms also thanks to last-minute pressures' (Bruxelles: debito ancora alto, bene i risparmi privati, *Il Sole 24 ore*, 14 February 2012, p. 5). Likewise, the fact that the 2013 EU Commission country-specific recommendations (CSRs) granted more time to some countries, notably Spain and France, to bring their public deficits below the EU's limit of 3% of GDP is a forceful example of the risk of arbitrariness that may characterise EU surveillance.[8] These examples are thus a strong reminder of the enforcement problems that the MIP is likely to face, especially in the absence of mechanisms that ensure an even-handed treatment of the countries under the new surveillance.

This observation also speaks to another potential weakness of the MIP. Specifically, the MIP builds on the application of asymmetric rules for bringing about macroeconomic adjustment. The asymmetry in question applies to creditor and debtor countries (De Grauwe, 2012). Indeed, although the new procedure builds on the assumption that Member States that accumulate large current-account surpluses are as much a source of macroeconomic imbalances as deficit states are, the new regulations also stress that 'the need

[8] In addition to Spain and France, the Commission's recommendations, which were issued in May 2013, suggested an extension of the deadlines for correcting the excessive deficits in the Netherlands, Poland, Portugal and Slovenia.

for policy action is particularly pressing in Member States showing persistently large current-account deficits and competitiveness losses' (Regulation 1176/2011, preliminary clause 17). This asymmetric understanding of the risks embodied by surplus and deficit countries had been clearly articulated during the negotiations that led to the MIP. For instance, the Task Force set up by President Van Rompuy to chart a path of reforms for the EU economic governance concluded that policy action 'to address macroeconomic imbalances and divergences in competitiveness is required in all Member States, but … [g]iven vulnerabilities and the magnitude of the adjustment required, the need for policy action is particularly pressing in Member States showing persistently large current-account deficits and large competitiveness losses.'[9]

The asymmetry inscribed into the MIP is further evident in the scoreboard thresholds that have been chosen to provide a signalling device for potentially harmful current external imbalances. Indeed, the indicative thresholds are by themselves asymmetric in that they refer to +6% of GDP for detecting surpluses and -4% of GDP for detecting deficits.[10] In other words, the MIP is an example of the way in which reforms of economic governance in Europe have focused narrowly on the implications of persistent deficits (Jones, 2011). Serious doubts can be raised, however, about the success of this uncooperative strategy (see, also, Temin and Vines, 2013). Similarly to what happened during the Asian crisis, when the IMF pushed all crisis-hit countries to adopt more contractionary, rather than more expansionary, policies that exacerbated the downward spiral in the region (c.f. Stiglitz, 1997), asking EU debtor countries to cut labour costs and reduce deficits while not asking surplus countries to share the burden of adjustment by stimulating their aggregate demand has thus far proven to be a drag on economic recovery. In particular, the spill-over effects of coordinated fiscal consolidation across almost all EU countries have been translated into a large negative impact on growth (Holland and Portes, 2012). Furthermore, the strategy associated with asymmetric adjustment risks creating public backlash and resentment towards the EU, similarly to

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[9] Report of the Task Force to the European Council, *Strengthening Economic Governance in the EU*, 21 October 2010.

[10] Specifically, the scoreboard indicator is the three-year backward moving average of the current account balance expressed in percent of GDP, based on Eurostat data.

what has been noted for the top-down IMF approach discussed above. That is to say, an asymmetric treatment diminishes the effectiveness of international surveillance procedures if citizens (and domestic authorities) perceive that they are being treated differently and with harshness – as evidenced by the pronounced rise of Eurosceptic attitudes among the EU debtor countries (Serricchio, Tsakatika and Quaglia, 2013).

In addition to the problem of asymmetrical treatment, the effectiveness of the MIP could be weakened by the predominant single-country focus of the new procedure, which may lead to missing (or downplaying) important systemic macroeconomic and financial developments. Indeed, although important attempts have been made to integrate the MIP within the broad EU economic surveillance framework, the core of the MIP surveillance revolves around the task of detecting problems in domestic policies that risk undermining each member's macroeconomic stability. Given this prevalent one-country focus, and similarly to what has been noted for the IMF, the findings of the MIP risk being weakened because of the lack of a holistic picture that takes into consideration various sources of risks and their interconnections. This narrow perspective could be detrimental to the task of preventing instability and thus to the effectiveness of the MIP procedure.[11] Indeed, if the monitoring activity is excessively focused on domestic economic policies and their prospective development, the ability to identify the signs of impending crises at the aggregate EU level may be negatively affected.

The effectiveness of the MIP could also be weakened by the separation of economic and financial analyses, again, one of the flaws that has long undermined IMF surveillance. For the MIP, the limited incorporation of financial sector issues into macroeconomic analyses is a serious weakness, especially in light of the experience of the recent sovereign debt crisis. Indeed, the rise in public debt levels in euro area countries was most significant in relative terms in a few countries that started from low levels of debt, such as Spain and Ireland. This condition points to the fact that macroeconomic stability can be negatively affected by unsustainable developments in the financial sector. Capital flows were also pivotal in the build-

[11] On the importance of shifting towards increased systemic surveillance of the economic and financial system, see, for instance, IMF, Bank for International Settlements, and the Financial Stability Board, 2009.

up of imbalances before the crisis because they were either used to finance construction booms or because they financed consumption (c.f. Gros, 2012).

To do justice to the MIP, it is worth noting that although the first version of its scoreboard only included major macroeconomic indicators, a new financial indicator was added in 2012. The scoreboard now includes an indicator of the growth rate of financial liabilities, which is meant to provide a measure of the expansion of the exposure to potential risks in the financial sector (European Commission, 2012). This is certainly a welcome development, but too strict a separation between economic and financial analysis is still an unsolved problem, especially in light of the changes in the EU financial governance that followed the publication of the de Larosière report (de Laroisière, 2009; Quaglia, 2013) and the delegation of supervisory powers to the ECB.[12] For instance, although one of the tasks of the newly created European Systemic Risk Board (ESRB) will be to identify excessive credit growth, which may well give rise to serious imbalances, the arrangements that govern the new macroeconomic surveillance fall short of what would be desirable to establish adequate coordination with the ESRB in this crucial area (Wyplosz, 2010).

In conclusion, the effective functioning of the MIP may well suffer from many of the same problems that have diminished the effectiveness of IMF surveillance. In particular, the institutional design of the MIP does not ensure that political considerations and asymmetric treatment of Member States will not interfere with the activation of sanctions and the content of the recommendations issued to member countries. Arbitrariness and asymmetric treatment could also be detrimental to the MIP's effectiveness if they generate public and political backlashes. Furthermore, the MIP's effectiveness might be diluted by its predominant single-country focus and limited integration of economic and financial analyses, which may lead the new procedure to miss important systemic developments.

Conclusions

[12] Interview with ECB officials, 3 June 2013.

It is often the case in the history of the EU that the beginning of a crisis sparks a round of institutional reforms aimed at deepening the level of integration and allowing the EU to respond to new challenges. The sovereign debt crisis has been no exception, as demonstrated by the creation of the MIP, amongst other reforms. By examining the institutional design and operating procedures of the MIP, this paper has begun to assess its potential effectiveness through a comparison with the Fund's macroeconomic surveillance.

Although a definitive conclusion on the MIP would be premature at this stage, the comparison with the Fund's macroeconomic surveillance provides a nuanced assessment of the effectiveness of the MIP. On the one hand, the comparison reveals that the MIP is much better placed than its IMF counterpart in identifying imbalances and inducing corrective action because the new procedure performs better than the Fund's surveillance in terms of the provision of clear and practical advice, knowledge of domestic polities and ease of activating sanctions. On the other hand, the MIP has not remedied some of the well-known weaknesses that have long undermined the effectiveness of IMF surveillance, as evidenced in its historical development and practical experience. Specifically, the MIP does not provide for mechanisms to prevent political and arbitrary considerations from interfering with the decision to activate sanctions and on how to share the burden of adjustment. Furthermore, the problems associated with uneven, asymmetric surveillance have not been attenuated but are ingrained in the workings of the MIP, thus increasing the probability of public backlashes. The single-country focus of the MIP procedure and the thus far limited integration of macroeconomic and financial analysis is another factor that may potentially undermine the overall effectiveness of the new surveillance.

Given the EU's inability to fully incorporate the lessons that were available from the Fund's experience, in these conclusions, it is worth reflecting on the factors that may help explain the null hypothesis of this lack of learning (Radaelli, 2009). This lack of learning is all the more puzzling because of the presence of all the textbook conditions that the literature suggests for learning to take place, including the pressure exerted by economic crises (Dolowitz and Marsh, 2000, p. 7), policy failures and dissatisfaction with the status quo (Rose, 1991, p. 10) and interaction with international organisations (IOs) (Finnemore, 1996). These conditions were precisely those in place in the EU at the time the MIP was proposed and adopted. Indeed, dissatisfaction with the Eurozone economic governance was certainly high following the financial turmoil in the sovereign debt markets of some Member States in 2009-10. Furthermore, interaction with the IMF has rarely been greater than following the Fund's involvement with the EU rescue programs and its role in monitoring the economic developments of the recipients of financial assistance.

To account for the lack of learning, it is possible to briefly speculate on at least three factors that contributed to this outcome (which also suggest areas for future research). First, foreign experience competed with domestic experience. Specifically, the experience with the SGP provided a more familiar base for learning than the Fund's surveillance and thus oriented the debate on the MIP since its negotiation. Indeed, participants in the negotiations recall that the creation of the MIP was never discussed on its own but as part of a 'package' that included the reform of the SGP. In this process, the Commission held the SGP as a model for the MIP so that the emerging new surveillance would be aligned with the other EU surveillance procedures.[13] As the EU Commission puts it, 'The overall design follows the implicit logic of the stability and growth pact with a "preventive" arm and a stronger "corrective" arm for more serious cases.'[14] This perspective suggests that, especially under crisis conditions, policy-makers may face competing incentives to select the sources of policy learning.

EU institutional fragmentation is another factor that hindered the process of learning from outside experiences. Although the EU Commission played the agenda-setting role in the development of the institutional design of the MIP, several other actors were involved in the process, including the Council (through the ad hoc working group on economic governance), the European Parliament and the ECB (with a consultative role).[15] This crowded landscape is likely to have focused attention more on the need for EU-level coordination than on the transfer of knowledge from abroad. It is therefore logical to conclude that

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[13] Interviews with officials at the ECB and EU Commission, Frankfurt and Brussels, April 2012 and May-June 2013.

[14] EU Commission, The MIP Framework, http://ec.europa.eu/economy_finance/economic_governance/macroeconomic_imbalance_procedure/mip_framework/index_en.htm.

[15] Interview with participants in the MIP negotiations, Frankfurt and Brussels, April 2012, June 2013.

the EU institutional system, in which several actors often meet in multiple arenas, creates difficulties with downloading experience from abroad (Zito and Schout, 2009, p. 1114).

Finally, the involvement of member states in the development of the MIP and the political cleavage between creditor and debtor countries is a further element that helps account for the lack of learning from the Fund's experience. Indeed, during the negotiations on the new surveillance framework, the issue of 'who adjusts' was one of the major bones of contention among member countries, with the representatives of the southern European states advocating for a symmetrical treatment of current account balances (Essl and Stiglbauer, 2011, p. 111). Similarly to what has been noted regarding the institutional fragmentation discussed above, the political economy of the MIP negotiations is likely to have directed more attention to the need to forge an internal compromise rather than to learn from the most relevant international experiences.

In conclusion, the comparison between the IMF and the new EU macroeconomic surveillance provides useful insights into the relative effectiveness of the latter. At the same time, the comparison also provides the building blocks from which to begin reflecting on the factors that may account for the process of inter-institutional learning (or lack thereof). Specifically, future research will be warranted to clarify when the selection of one experiential basis (domestic or international) either 'crowds out' or complements another. Further research will also be needed to identify the conditions under which EU-specific factors are an obstacle or an aid to the transfer of knowledge from outside experiences.

Table 1. Causes of the ineffectiveness of IMF surveillance

	Prevention	**Correction**
Content	Poor timeliness and lack of specific and practical advice Fragmented message and limited systemic analysis Poor coverage of financial sector issues and macro-financial linkages	Limited even-handedness and asymmetric treatment Limited knowledge of domestic polity and politics
Procedure	Insufficient insulation from political considerations	Limited involvement of national authorities (one-way street) Limited corrective measures and difficulties in activating sanctions

Table 2. The effectiveness of the MIP as compared to the Fund's macroeconomic surveillance

	Prevention	**Correction**
Content	*Increased timeliness and more practical advice* Fragmented message and limited systemic analysis Poor coverage of financial sector issues and macro-financial linkages	Limited even-handedness and asymmetric treatment *Increased knowledge of domestic polity and politics*
Procedure	*Introduction of mechanisms to facilitate the activation of sanctions* Insufficient insulation from political considerations	*Increased involvement with national authorities* *Reliance on corrective measures*

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